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THE SCOPE AND LIMITS OF THE RIGHT TO RETAIN CONTRACTUAL PERFORMANCE

Lorna Richardson*

The right to retain contractual performance which is otherwise due, when faced with a breach by the other party to the contract (sometimes referred to as “mutuality retention”),¹ is of significant practical importance. When A is sued by B, A will not wish to perform his contractual obligations unless B has performed hers. The right to retain is well established in Scots law but there are a number of difficulties with the current law.²

This is the first piece of scholarly work to consider the right of retention in a holistic fashion, considering all of the controls on the right to retain cumulatively. It is hoped that in doing so a better understanding of retention and, as a result, how it ought to develop in future will be achieved. The Scottish Law Commission recently decided not to recommend legislative reforms, instead leaving it to the courts to clarify and develop the law.³ This article may provide a springboard for such judicial development.

A. What is the Right to Retain Performance?

The right to retain in civilian systems is derived from the *exceptio non adimpleti contractus* (the defence of the unperformed contract).⁴ There are traces of such a rule in Scots law from the thirteenth century.⁵ The right to retain is based on the principle of mutuality in contract. Erskine stated,

No party in a mutual contract, where the obligations of the parties are the causes of one another, can demand performance from the other, if he

*Lecturer, University of Edinburgh. This article is dedicated to the memory of Prof Joe Thomson, a truly inspiring teacher, without whom I would not be where I am today. With thanks to Professor Laura Macgregor for commenting on earlier drafts of this paper and the anonymous reviewer for their comments. Any errors are my responsibility.

¹ Scottish Law Commission Discussion Paper on Remedies for Breach of Contract (Scot Law Com Discussion Paper No 163, 2017), chapter 2.

² This can be seen in the most recent Inner House case on retention, *JW&H Lamont of Heathfield Farm v Chattisham* [2018] CSIH 33. For further discussion of the problems with that case see L Richardson, “What do we know about retention now?” 2018 ELR 387.

³ Scottish Law Commission Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties (Scot Law Com Report No 252, 2018), para 11.32.

⁴ WW McBryde, *The Law of Contract in Scotland*, 3rd ed (2007), para 20.44. A detailed account of the history of retention and lien is provided in AJM Stevens, *Pledge and Lien*, 2008, chapter 10. See also the discussion of the history of the *exceptio* in the South African case of *BK Tooling (Pty) Ltd v Scope Precision Engineering (Pty) Ltd* 1979 (1) SA 391 (A).

⁵ Marioun Lady Somervale, July 10, 1492, ADC 1.246; and the discussion in McBryde *ibid*; WW McBryde, “Remedies for Breach of Contract”, 1996 ELR 43, p 64.

himself either cannot or will not perform the counterpart, for the mutual obligations are considered as conditional.⁶

The essence of the right to retain is that a party to a contract (A) need not perform his obligations under the contract if his contracting partner (B) will not perform her contractual obligations.

It is clear that retention operates as a self-help remedy: A can retain his performance during the period in which B has failed to perform her obligations. In this way A's retention exerts pressure on B to perform. When B performs A must also perform; the right to retain lasts only as long as there is a breach of contract by one's contracting partner. While some doubt has recently been cast on the matter⁷ retention also operates as a defence to an action: A can plead retention should B raise proceedings against him seeking implement of his obligations, or damages for his breach of contract. Retention permits a party to retain performance where failure to perform would otherwise amount to a contractual breach.

Retention is a temporary remedy. It does not resolve the dispute between the parties. A may retain and, as a result, B performs. As noted above A would then have to perform. As such retention can be brought to an end by a contracting partner's performance. Where retention is used as a defence it may result in performance, the payment of damages or compensation:⁸ A may sue B for performance, B would have a right to retain until A performed his obligations or paid damages in lieu thereof. A may do so and B would therefore have to perform her obligations. Retention may be followed by compensation: A sues B for payment or damages for breach of contract, B claims retention due to A's breach, and counterclaims for damages as a result of that breach. The court will determine the respective claims; and where monetary sums are due to and by each of the parties the sums will be set against each other in extinction of the obligations, with the party owing the higher amount paying over the balance to the other.

While retention is clearly a useful remedy and is often pled when a party is sued for breach of contract⁹ the scope of its use and the way in which it ought to be controlled have caused significant difficulty. Despite this, no scholarly work has, to date, considered the controls on the right to retain in a comprehensive fashion. This article does so. Case law has suggested how each of the different controls on the right to retain should operate but no cases have considered all controls together or considered their interaction with each other. Taking a more holistic approach is

⁶ Erskine's *Institute* IV.iii.86.

⁷ As discussed at p 12 below.

⁸ This is the Scottish term for setting liquid claims against each other. It is similar to legal set-off in English law.

⁹ Recent examples include *Burnside v Promontaria (Chestnut) Ltd* [2017] CSOH 157 and *Lamont v Chattisham* [2018] CSIH 33.

important: if one control is set at a relatively low level that might suggest that another should be set at a higher level to ensure that the right to retain is kept within appropriate limits and is not used abusively. Without taking such an approach, and recognising the interplay between controls, the discussions on the limits of the right to retain are incomplete and can result in one control developing in a particular way, where in fact, another control can better deal with the perceived problem. It is hoped that by drawing attention to this courts in the future will bear in mind all of the controls on the right to retain to allow this important practical remedy to be developed in a coherent manner.

B Current Controls on the Right to Retain

Having set out how the right to retain operates, this part considers current controls on the use of the right and the problems with those controls. Each of the controls will be considered in turn, before going on to consider the interaction between them.

At this stage it should be noted that retention does not appear to require any proportionality between A's breach and the performance retained by B.¹⁰ For instance, A may sue B for the price due to A of £25,000. Suppose that B has suffered loss due to a breach by A of the contract in terms of which the price is due. B may retain her obligation to pay £25,000 until her damages claim has been determined. B's quantification of her claim may be £5,000, with that being the sum sued for, not the sum found due by the court. Nonetheless, B would be able to retain £25,000 until £5,000 had been found due to her in damages. At that stage both claims would be liquid and could be set against each other in compensation, with the result that B would have to pay to A the excess £20,000. The need to control retention from abuse is an issue that has arisen in the case law¹¹ and is a concern of solicitors.¹²

(1) Control One: The Obligations Must be Counterparts of Each Other

It is clear that for B to retain performance of her obligations they must be counterparts of the obligations which A has breached. There is an assumption that all of the obligations in a contract are the counterparts of the other. In *Inveresk v Tullis Russell* Lord Hope noted,

¹⁰ HL MacQueen and J Thomson, *Contract Law in Scotland*, 4th ed, (2016), para 5.21.

¹¹ For instance in *Graham v Gordon* (1843) 5 D 1207; *Earl of Galloway v M'Connell* 1911 SC 846; and *Stobbs & Sons v Hislop* 1948 SC 216. See more recently *Hoult v Turpie* 2004 SLT 308; *Inveresk plc v Tullis Russell Papermakers Ltd* 2010 SC (UKSC) 106; *McNeill v Aberdeen City Council* 2014 SC 335; *Lamont v Chattisham* [2018] CSIH 33.

¹² Scottish Law Commission Report on Remedies for Breach of Contract (Scot Law Com Report No 174, 1999) para 7.16. In the Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties (n3), a majority of consultees were of the opinion that the courts should have the power to deal with abuse of retention, para 11.27.

The guiding principle is that the unity of the overall transaction should be respected. The analysis should start from the position that all of the obligations that it embraces are to be regarded as counterparts of each other unless there is a clear indication to the contrary.¹³

The indication to the contrary can be in the wording of the contract or the way in which the contract is structured. For instance, where a contract is structured in phases, as is common with large-scale construction projects, the right of retention will likely operate only within each phase rather than across the contract as a whole. As such B would not be able to withhold payment in relation to phase two due to breaches of contract by A in phase one.¹⁴ A further example may be where a framework agreement is entered into between parties setting out how they will conduct business with each other but which does not, of itself, impose obligations on either of the parties. Obligations will only arise where an order is placed by one of the parties. In such a case B may not be able to withhold payment for order ten due to a breach by A in fulfilling order seven.

The parties' obligations need not be within the same contract for retention to operate. The important thing is that the unity of the transaction is respected. A transaction might be structured using a number of different contracts. Where that occurs it would allow B to retain her obligation under contract 1 where A was in breach of his obligation in contract 2. There does however have to be a connection between the contracts: they must be part of an overall transaction. This was the situation in *Inveresk*.¹⁵ *Inveresk* raised an action seeking payment of additional consideration due under an asset purchase agreement in terms of which *Inveresk* had sold various assets to *Tullis*. The parties had also entered into another contract, a services agreement, in terms of which *Inveresk* were to provide certain services to *Tullis*, including the manufacture, sale and distribution of specified products for a certain period of time. The agreements were related. They had been entered into on the same date and the entire agreement clauses in each contract referred to the other contract. The services agreement was to ensure continuity in manufacture and distribution of certain products pending their full integration into *Tullis*'s business following the asset purchase. The question for the court was whether *Tullis* could retain performance of their obligation to pay the additional consideration under the asset purchase agreement pending the outcome of a separate action which *Tullis* had raised against *Inveresk* for alleged breaches of the services agreement. The court found that *Tullis* were entitled to retain.

The discussion above indicates that this control of the right to retain sets a low threshold in assuming that all obligations in one transaction are the counterparts of the other. There have, however, been recent comments from the Inner House which

¹³ 2010 SC (UKSC) 106 at para 42.

¹⁴ *Bank of East Asia v Scottish Enterprise* 1997 SLT 1213; although such a position conflicts with the decision in *Turnbull v M'Lean* (1874) 1 R 730, as noted in *Hoult v Turpie* 2004 SLT 308 at para 11. Further doubt was cast on this aspect of *Bank of East Asia* by Lord Drummond Young in *Lamont v Chattisham* [2018] CSIH 33 at para 37. However in the same case Lord Malcolm used this aspect of *Bank of East Asia* with approval, para 53.

¹⁵ 2010 SC (UKSC) 106.

suggest a narrower approach to this issue, which would make it more difficult for obligations to be counterparts of each other, and as such would narrow the scope of the right to retain. In *McNeill v Aberdeen City Council*¹⁶ Lord Drummond Young¹⁷ stated that the right to retain was the ability to withhold substantive obligations under the contract when faced with a breach by the other party. He went on to explain that substantive obligations are

fundamental obligations that define what a contract is intended to achieve; in a contract for sale of goods these would be the supply of the goods and the payment of the price, and in a contract of employment they are the performance of services by the employee and the provision of salary or wages by the employer.¹⁸

This then suggests that only a breach of a main or primary obligation under a contract would trigger the right to retain a counterpart main or primary obligation. Based on this analysis there seems to be no right to retain in respect of ancillary obligations under a contract. Such an analysis is problematic for a number of reasons.¹⁹ Firstly, it is unsupported by recent Supreme Court authority. As noted above, in *Inveresk* the court held that the starting position was that *all* obligations in a transaction were to be considered the counterparts of each other.²⁰ Incidentally, Lord Drummond Young's comments ten years' earlier when sitting as a judge in the Outer House contradict his more recent deliberations. In 2004 he stated,

the principle of mutuality should not be interpreted in such a way that substantially curtails the availability of retention. That applies in particular to the requirement that the obligations should be counterparts of each other; that requirement should not be used in an artificial manner which breaks up the unity of a contract.²¹

In the same case he went on to note that there is "a presumption that *the whole* of the obligations on one side of a contract are the counterparts of *the whole* of the obligations on the other."²²

Secondly, it may be difficult to determine what the substantive obligations of a contract are. The sale example given in *McNeill* is fairly simple. Others are less obvious. The finding by the court in *McNeill* that the implied term of mutual trust

¹⁶ 2014 SC 335. He makes the same comments in *Lamont v Chattisham* [2018] CSIH 33 at para 30.

¹⁷ With whom Lords Eassie and McGhie agreed in relation to his analysis of contract law.

¹⁸ 2014 SC 335 at para 27.

¹⁹ Although there is a basis for the position; Stair I, 10, 16 sets out examples of obligations that are mutual causes of each other; for instance in sale, the obligation to deliver the ware and to pay the price, and continues, "otherwise the obligements are not the proper causes each of other...the one is but the occasion and motive, and not the proper cause of the other." See also the comments of Lord Neaves in *Turnbull v M'Lean* (1874) 1 R 730 at 739: "It is a general principle that all the material stipulations in a contract forming an *unum quid* are mutual causes".

²⁰ See the passage quoted at p 4 above.

²¹ *Hoult v Turpie* 2004 SLT 308 at para 9.

²² *Ibid* at para 10.

and confidence in an employment contract is not a substantive obligation has been questioned.²³ The position will be complicated in a complex commercial contract where there may be a great many obligations on each side, some of which may be obviously substantive, others clearly ancillary but many that may not clearly fit one category or the other. This problem has been recognised by the judiciary, with Lord Marnoch commenting that, “anything other than the simplest contract could endlessly be broken down and the law reduced to uncertainty, impracticality and obscurity.”²⁴ This is a particular concern given retention can operate as a self-help remedy. Where a self-help remedy is available it should be clear when that remedy is available.²⁵

Finally, where there is a breach of a substantive obligation this is more likely to be a material breach of contract, entitling the other party to rescind. Retention is a useful remedy where there is a breach that is not so serious as to permit rescission. By narrowing the availability of retention to substantive obligations only much of its utility may be eroded. The court in *McNeill* in seeking to control the right to retain to ensure that contractual obligations are performed, missed the important role that a readily available right to retain can have: it may force A to perform his contractual obligations since if he does not do so he knows that B will be able to retain performance of her obligations.

For these reasons it is suggested that Scots law should not develop in the direction foreshadowed by the Inner House in *McNeill* but find other, more suitable ways to control the right of retention.

(2) Control 2: The Breach must be Material

For retention to be available to B, A’s breach of his counterpart obligation must be material. McBryde notes that the Scottish authorities refer to material breach usually in the same sense as is required for rescission of contract.²⁶ It is therefore necessary to consider what is meant by material breach justifying rescission. It is only where a breach is material that the party faced with the breach can elect to rescind.²⁷ A material breach has been described in various ways: as a serious or

²³ JM Thomson, “An Unsuitable Case for Suspension?” 1999, ELR 394; and D Cabrelli, “The Mutuality of Obligations Doctrine and Termination of the Employment Contract: *McNeill v Aberdeen City Council (No 2)*” 2014, ELR 259. It is difficult to reconcile the finding that the implied term of mutual trust and confidence is not a substantive obligation when breach of the duty of good faith in a partnership contract by A was held to entitle B to withhold performance of its obligation in *Forster v Ferguson & Forster, Macfie & Alexander* 2010 SLT 867.

²⁴ *Forster*, *ibid*, at para 28.

²⁵ Discussion Paper on Remedies for Breach, 2017 (n1), para 2.14.

²⁶ McBryde, *Contract* (n4), para 20.60.

²⁷ Scots law does not classify contractual terms into conditions, breach of which would give rise to the right to terminate; warranties, breach of which gives rise to a remedy in damages only; and innominate terms, breach of which would give rise to the right to terminate where the consequences of the breach are sufficiently serious.

substantial breach; as a breach going to the root of the contract; or a breach going to the essence of the contract.²⁸ In a famous passage Lord President Dunedin noted,

It is familiar law, and quite settled by decision, that in any contract which contains multifarious stipulations there are some which go to the root of the contract that a breach of those stipulations entitles the party pleading the breach to declare that the contract is at an end. There are others which do not go to the root of the contract, and which would give rise, if broken, to an action of damages.²⁹

In determining whether or not a breach is material one must consider the nature of the breach. The consequences of the breach are not determinative, although they may illustrate materiality.³⁰ The matter is a question of fact, determined by considering the circumstances at contract formation, and subsequently.³¹ It can be difficult to decide whether a breach is material unless the parties have expressly provided for this in their contract.³² Given the question of whether a breach is material is so fact dependent other cases in which a breach has been held to be material are likely to be of little assistance.

There is however, more recent authority which indicates that the level of materiality required for the right to retain is not as high as that needed for rescission.³³ It is suggested that this authority is to be preferred. Retention is not as drastic as rescission; it does not bring performance of all future obligations under the contract to an end. As noted above, retention is an interim remedy; suspending performance of obligations until counter obligations are performed or damages paid in lieu of such performance. As such, it is misplaced in the context of retention to require material breach to the same degree of materiality as is required for rescission.

This however creates further difficulties. The first is a terminological difficulty: it is confusing to talk of material breach and mean different things depending on context. The second, and more pressing, issue is that if the breach need not be so material as to justify rescission, how material does it have to be? To this Scots law has no answer. The problem may best be illustrated diagrammatically:

²⁸ McBryde, *Contract* (n4), para 20.91 and the authorities cited there.

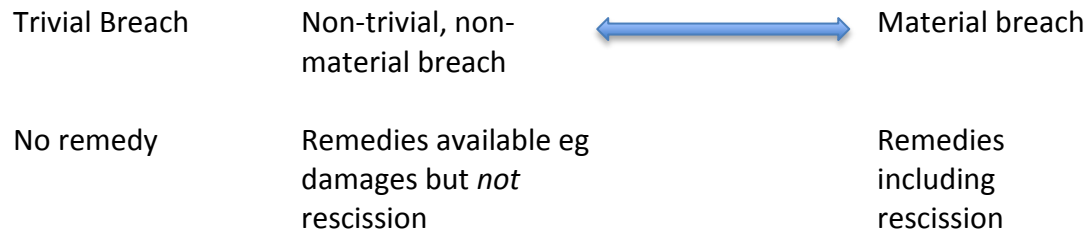
²⁹ *Wade v Waldon* 1909 SC 571 at 576.

³⁰ McBryde, *Contract* (n4), paras 20.93-20.94.

³¹ *Ibid* para 20.96.

³² Although the ultimatum procedure may be used by the party alleging breach of contract where there is doubt as to the materiality of the breach or where the breach is not material. Using the ultimatum procedure can provide clarity that the breach is a material breach.

³³ *Inveresk* 2010 SC (UKSC) 106 per Lord Hope at para 43; and *EDI Central Ltd v National Car Parks Ltd* 2011 SLT 75, per Lord Glennie at para 111.



What is unclear is where between the arrows the breach is sufficiently material for retention to be available.³⁴ Should the breach fall just short of being a material breach in the sense used for rescission or would a breach just a little more serious than a non-material breach suffice? Even where a standard of materiality is determined as the applicable threshold, it may, as with rescission,³⁵ be difficult to determine when a breach has reached that threshold.³⁶

That this is so with a self-help remedy where non-lawyers may have to decide, without the benefit of legal advice, and possibly within short timescales whether they can withhold their performance indicates that there are problems. It leads one to question what the materiality control is seeking to do and whether this could be achieved in another way, using an alternative control. The materiality requirement is seeking to ensure that B can withhold *all* of her counterpart obligations only when faced with a sufficiently serious breach of contract by A. It is thought that the fact that there need be no proportionality between the obligation breached by A and the performance withheld by B is the major difficulty here. In this respect Scots law differs from most other European systems, which have a proportionality or reasonableness requirement, often based on the obligation to exercise remedies in good faith.³⁷ The problem with a lack of proportionality in Scots law is particularly acute given the wide availability of retention due to the low threshold of the first control: the obligations being counterparts.

There are further reasons to doubt the continued use of the materiality control. It seems that the Scottish courts took a wrong turn in beginning to consider materiality as a requirement of retention. As noted above, the right to retain in civilian systems is derived from the *exceptio non adimpleti contractus*. In those systems there is generally no need for the breach to be material, or indeed, of any standard to trigger

³⁴ MacQueen and Thomson note that the exact nature of the difference between the two levels of materiality has not been much explored, (n10), para 5.12.

³⁵ See the discussion on p 7 above.

³⁶ See the difficulty in doing so in *Hoult v Turpie* 2004 SLT 308 at para 10.

³⁷ The commentary to Art III-3:401 of the DCFR in C von Bar, E Clive and H Schulte-Nölke, *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR)*, Full Edition (2009), p848. A good faith control of retention in Scotland was not supported by consultees to the Scottish Law Commission's 1999 Report on Remedies (n12), para 7.18. Good faith was not considered as a control by the Commission in the Discussion Paper on Remedies for Breach, 2017 (n1), instead the SLC mentioned the equitable control of the court.

the right to retain.³⁸ This is reflected in the rule found in Art III-3:401 of the DCFR. The institutional writers did not refer to materiality.³⁹

Materiality of breach entered Scots law through the acquisition of unilateral rescission of contract from English law by the Scottish courts.⁴⁰ It appears that the linking of materiality to mutuality and thus to retention occurred in *Turnbull v M'Lean*⁴¹ in which Lord Justice-Clerk Moncreiff stated,

I understand the law of Scotland, in regard to mutual contracts, to be quite clear – 1st, that the stipulations on either side are the counterparts and the consideration given for each other; 2nd, that a failure to perform *any material or substantial part* of the contract on the part of one will prevent him from suing the other for performance; and 3rd, that where one party has refused or failed to perform his part of the contract in any material respect the other is entitled either to insist for implement, claiming damages for the breach, or to rescind the contract altogether, except so far as it has been performed.⁴²

As can be seen, in the second comment made in the passage quoted above the Lord Justice-Clerk links materiality with mutuality. However, it must be noted that the main question at issue in *Turnbull* was whether M'Lean was able to rescind the contract for non-payment of sums found to be due by Turnbull.

McBryde draws attention to the fact that in another case in the same year, *Davie v Stark*,⁴³ Lord Justice-Clerk Moncrieff seems to have realised that materiality was only required for rescission⁴⁴ when his Lordship noted,

The other party is entitled either to refuse implement until the stipulations in his favour have been fulfilled, or, provided that the latter are material and essential, to rescind the contract altogether.⁴⁵

However, given other comments made in the case, such as Lord Justice-Clerk Moncrieff's statement that he entirely

³⁸ McBryde, *Contract* (n4), para 20.60. However, in French law the breach needs to be "sufficiently serious" to allow retention: CC Art 1219. See the discussion of this provision in T Genicon, "The Exception d'Inexécution" in J Cartwright and S Whittaker (eds), *The Code Napoléon Rewritten*, (2017), p298.

³⁹ See for eg Erskine's *Institute* IV.iii.86, quoted on p 1 above; and Stair's *Institutions* I.10.16.

⁴⁰ McBryde, *Contract* (n4) para 20.88; D Johnstone, "Breach of Contract" in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland*, Vol 2, (2000), p183.

⁴¹ (1874) 1 R 730. Although it may have been foreshadowed by Lord Cowan's comments in *Barclay v Anderston Foundry Co* (1856) 18 D 1190 at 1197 where he stated that a gross or unreasonable disregard of an obligation would result in the party in such breach being unable to insist on contractual performance by his contractual partner.

⁴² *Ibid* at 738, emphasis added.

⁴³ (1876) 3 R 1114.

⁴⁴ WW McBryde, "The Scots law of breach of contract: A mixed system in operation" 2002 ELR 5, p 13.

⁴⁵ *Davie v Stark*, (n43) at 1119.

“adhered to the views expressed in *Turnbull*, that failure to perform any material part of a mutual contract by one of the parties will prevent him from insisting on implement against the other”⁴⁶

this is unclear.⁴⁷

Notwithstanding the perhaps rocky foundation for materiality in the context of retention it has taken hold; *Turnbull* was approved by the House of Lords in *Bank of East Asia v Scottish Enterprise*⁴⁸ with Lord Jauncey⁴⁹ referring to a material breach. Further, in *Inveresk* Lord Hope commented that the materiality requirement seemed to be a useful protection against abuse of the right to retain, provided it was understood that the level of materiality required is not that which is required for rescission.⁵⁰

A further reason to doubt the materiality requirement is that special lien,⁵¹ where B need not return A’s corporeal moveable property to A until A has paid B for the work carried out on or in relation to the goods, is an example of retention based on the principle of mutuality in contract.⁵² Yet there is no need for A’s breach to be material before B can utilise her special lien.⁵³ It is therefore anomalous to require a material breach before retention is available.

Finally, it has been argued, it is suggested correctly, that retention should be permitted provided the breach is more than trivial given that if a non-material breach by A allows him to seek full performance by B “the law may well have departed from the common expectation”.⁵⁴

(3) Control 3: The Court has Equitable Control of the Right

The right to retain is a legal right but it is not absolute; the court can refuse to permit a party to retain where it considers that it would be inequitable to do so.⁵⁵ This control mechanism has not featured significantly in cases over the last century⁵⁶ but it has come to the fore in some recent cases. In *Inveresk* Lord Hope noted that the right of retention is not an absolute right and that the court has the power to

⁴⁶ *Ibid.*

⁴⁷ As McBryde concedes in *Contract* (n4), para 20.59.

⁴⁸ *Bank of East Asia* 1997 SLT 1213.

⁴⁹ With whom the other members of the bench agreed.

⁵⁰ *Inveresk* 2010 SC (UKSC) 106 at para 43.

⁵¹ In terms of which B has possession of A’s goods in order to do some work to or on them, eg a cobbler with possession of shoes.

⁵² Steven, *Pledge* (n4), para 16.01.

⁵³ McBryde, *Contract* (n4), para 2.61.

⁵⁴ McBryde, “Remedies for Breach” (n5), p 65.

⁵⁵ WM Gloag, *The Law of Contract*, 2nd ed, (1929), p627 and the authorities cited there; HL MacQueen and J Thomson, *Contract* (n10), para 5.21.

⁵⁶ It is discussed in cases regarding retention of rent by tenants, for instance *Earl of Galloway v M’Connell* 1911 SC 846; and *Stobbs & Sons v Hislop* 1948 SC 216. It was also mentioned in *British Motor Body Co Ltd v Thomas Shaw (Dundee) Ltd* (1914) SC 922, a case on the supply of goods.

prevent its abuse.⁵⁷ In both *McNeill* and *JH&W Lamont of Heathfield Farm v Chattisham*⁵⁸ Lord Drummond Young identified the court's equitable control as an important feature of the remedy. He noted,

In view of the potential range of such a remedy, it seems to me to be imperative that the court should be able to ensure that it does not become an instrument of abuse. That can readily be achieved by equitable control; in any particular case the court may exercise a discretion as to whether retention should be permitted to operate, and if so on what terms.⁵⁹

The authorities suggest that the court can refuse to allow a party to retain his contractual performance. It is important to note that the party faced with a breach has a right to retain but use of the right can be curtailed by the court in the exercise of its discretion.⁶⁰

What is less clear is when the court will find that it should exercise its discretion and, further, how it will exercise that discretion; the equitable control of the court being recently described as "undeveloped".⁶¹ As to the former, it has been suggested that where B pleads retention simply as an excuse to delay performing her obligation to A then the court should refuse to permit retention.⁶² It has recently been suggested that where B claims a breach of contract by A, and seeks damages, in defence to an action by A for performance under the same contract such a claim had to be looked at critically by the court to determine whether it is fair and just that it should be allowed.⁶³ This seems to turn the test on its head. Mutuality retention is available as of right unless and until the court determines that it is being used inequitably.⁶⁴ The court should therefore start from the position that B is able to retain, provided she has sufficiently specific averments regarding the breach and loss, unless there are circumstances which demonstrate that it would be inequitable to allow B to do so.⁶⁵

As to how the court will exercise control, in some cases⁶⁶ reference has been made to the fact that the court may order that B consigns⁶⁷ the sum sued for by A to court.

⁵⁷ *Inveresk* 2010 SC (UKSC) 106 at para 34.

⁵⁸ [2018] CSIH 33.

⁵⁹ *McNeill* 2014 SC 335 at para 30.

⁶⁰ In this way retention, on the basis of mutuality of contract, is different from the other form of retention in the law of obligations, special retention. Special retention is not available as of right. It can only be used where the court is satisfied that circumstances exist which mean it should exercise its discretion to allow a party to retain their performance. For further discussion see L Richardson, "Examining 'Equitable' Retention" 2016, ELR 18.

⁶¹ Discussion Paper on Remedies for Breach, 2017 (n1), para 2.32.

⁶² Gloag, *Contract*, (n55), p627; *Earl of Galloway v M'Connell* 1911 SC 846.

⁶³ *Lamont v Chattisham* [2018] CSIH 33 per Lord Drummond Young at para 44.

⁶⁴ Determining whether it is just and equitable to permit A's damages claim to delay B's liquid claim is part of the law referred to as special retention, not mutuality retention; see L Richardson "Examining Equitable Retention" (n60).

⁶⁵ This is the case with specific implement, where the court starts from the position that the remedy is available unless, in the exercise of its discretion the court considers it should not be granted: see *Grahame v Magistrates of Kirkcaldy* (1882) 9 R (HL) 91 and the discussion on p21-22.

⁶⁶ *Inveresk* 2010 SC (UKSC) 106 per Lord Hope at para 34; *Earl of Galloway v M'Connell* 1911 SC 846.

⁶⁷ The party must lodge the sum with the court.

Where that occurs B is not retaining performance, as such, but is not giving the benefit of his performance to A, until the dispute before the court has been resolved. Beyond this, there is no clear guidance as to how the right to retain may be controlled by the court.

The issue has however been discussed in *obiter* comments by the Inner House. In *McNeill*⁶⁸ the court opined that if a breach of the obligation of mutual trust and confidence by the employee permitted the employer to withhold its obligation of mutual trust and confidence (which the court had found it was not able to do, such an obligation not being substantive) this would have permitted the employer to behave in a manner that wholly disregarded the employee's interests. This could have led to manifest unfairness, allowing the employer to behave in a wholly outrageous manner. Retention should not, said the court, be able to achieve such a result and, had retention otherwise been available, the court would have found its use inequitable. *McNeill* demonstrates that there may be particular types of contracts and / or contractual terms where the court may wish to control the right to retain.⁶⁹

In the recent case of *JH&W Lamont* two members of the Inner House opined that the availability of diligence on the dependence was a factor suggesting that it would be inequitable to allow the defender to retain performance.⁷⁰ Why this should be the case is unclear. Firstly, retention is a defence and defenders are unable to seek diligence on the dependence. Secondly, even where the defender counterclaims, and thus would be able to seek diligence on the dependence, many creditors raising an action have the possibility of seeking diligence on the dependence.⁷¹ Why should the availability of diligence on the dependence prevent the defender from exercising his *right* to retain his performance? It is suggested that it should not.

A further, and significant, restriction on the right to retain was suggested in *McNeill* where the court considered the fact that retention was to secure future performance only as an important feature of the equitable control of the right.⁷² Lord Drummond Young stated that retention was

⁶⁸ For discussion of the case see Cabrelli, "The Mutuality of Obligations Doctrine and Termination of the Employment Contract: *McNeill v Aberdeen City Council (No 2)*" (n23).

⁶⁹ The obligation of mutual trust and confidence in employment contracts has created problems for the courts regarding the right to retain: see also *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628 and criticism of the case by Thomson, "An Unsuitable Case for Suspension?" (n23).

⁷⁰ Lord President Carloway at para 24 and Lord Drummond Young at para 46.

⁷¹ The actions where diligence on the dependence can be sought include all claims for payment of a sum – see s15A(2) of the Debtors (Scotland) Act 1987 and s9A(2) of the Debt Arrangement and Attachment (Scotland) Act 2002.

⁷² *McNeill* 2014 SC 335 at para 30. Lord President Carloway in *Lamont v Chattisham Ltd* [2018] CSIH 33 also considered that the right to retain only operated to secure future performance.

a right to withhold performance of substantive obligations under the contract pending performance by the other party of its obligations. The right does not go further than that.⁷³

He also stated “the principle of retention cannot generally be invoked in respect of a breach of contract that has occurred in the past and is unlikely to be repeated.”⁷⁴

It is argued that retention is not so limited. Indeed, Lord Drummond Young appears to accept that in the recent case of *JH&W Lamont*.⁷⁵ While the reason B retains performance, in many cases, will be to try to force A to carry out his reciprocal obligation, retention can and should also ensure that B will not have to perform her contractual obligations unless and until A performs his reciprocal obligations or pays damages in lieu of performance.⁷⁶ In this way retention is also a defence to an action raised by A.⁷⁷ As noted above,⁷⁸ security for future performance is only one facet of retention, the other being as a defence to a claim for performance or damages for breach of contract.⁷⁹

There is no conceptual reason for retention to be limited so that it protects only those parties who may still be able to obtain performance or wish to obtain useful performance from their contracting partners. There is no sound basis on which A should be able to obtain decree requiring B to perform her contractual obligations simply because the performance of A’s obligations is no longer possible or desirable. On the analysis set out in *McNeill*, A could obtain the benefit of performance under the contract from B in such circumstances, leaving B to seek damages from A despite the fact that B was retaining performance in the face of a breach of a counterpart obligation by A. In *Forster v Ferguson & Forster, Macfie & Alexander*⁸⁰ the court held that the mutuality doctrine, rather than retention, could be used by B to defend a claim by A in such circumstances. Mutuality would prevent A from seeking performance by B due to A’s breach. However, this may produce injustice between the parties. Suppose A defectively performs his obligations under the contract, for example by delivering defective goods to B. As a result B has suffered a loss. Should A be prevented by mutuality from seeking performance, i.e. any payment from B? Suppose that B’s loss is significantly less than the contract price for the goods.

⁷³ *McNeill* 2014 SC 335 at para 28. Although see the comment at para 30 that, if the right of retention is invoked for a purpose other than security for future performance, “it *may* well be appropriate to hold that its exercise is inequitable” (emphasis added).

⁷⁴ *Ibid*, para 29. Similar comments were made by Lord Caplan in *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628.

⁷⁵ [2018] CSIH 33 at para 35.

⁷⁶ Gloag, *Contract* (n55), p 623, 626-627.

⁷⁷ McBryde, *Contract* (n4), para 20.48. McBryde suggests this is the limit of the mutuality principle and it does not mean that a party in breach cannot sue at all under the contract, despite authority which suggests this: see the discussion at para 20.48-20.52; MacQueen and Thomson, *Contract* (n10) para 5.23; WM Gloag and JM Irvine *Law of Rights in Security: Heritable and Moveable Including Cautionary Obligations* (W Green, Edinburgh, 1897), p 306.

⁷⁸ See p 2.

⁷⁹ In this latter respect retention performs a function similar to equitable set-off in English law.

⁸⁰ 2010 SLT 867.

Preventing A from making a claim for payment on the basis of mutuality, gives B a windfall benefit. Allowing retention to operate such that B can retain the price until A pays damages for B's loss would produce justice between the parties.⁸¹

There are a number of authorities,⁸² including *Inveresk*⁸³ where a defender has been held entitled to retain his performance despite the fact that his contracting partner was no longer able to perform his obligations; such that retention was not being used to secure future performance. In *Inveresk* Tullis were held to have legitimately exercised the right to retain when retaining their performance would not prompt performance by Inveresk of their obligations under the services contract. The period for performing those obligations had passed and Tullis were simply seeking damages for breach of the services contract.

It is suggested that the court's comments in *McNeill* were an attempt to confine and control the operation of retention. There was a clear concern that retention should not be used in an abusive fashion.⁸⁴ While there is a need for such a broad and flexible right to have limits placed on its use it is argued that seeking to restrict retention to security for future performance only is not the correct way to do so. As such retention being used other than to secure future performance should not result in a finding that it is being used inequitably.

(4) Control 4: The Claims Must be Contemporaneous

There is a control which is often overlooked. This is an uncontroversial issue,⁸⁵ which relates to the timing of performance. Party B is only able to withhold her contractual performance if A has breached a contractual obligation before the date on which B would have to perform her obligation under the contract.⁸⁶ If on date X, B is due to pay A £y and if A has not breached the contract or, it may be added, B is not aware

⁸¹ See McBryde, *Contract* (n4), para 20.48-20.52; and MacQueen and Thomson, *Contract* (n10), para 6.57-6.58.

⁸² See *Taylor v Forbes* (1830) 9 S 113; *MacBride v Hamilton and Son* (1875) 2 R 775; *Gibson and Stewart v Brown and Co* (1876) 3 R 328; *Sharp v Rettie* (1884) 11 R 745; *British Motor Body Co Ltd v Thomas Shaw (Dundee) Ltd* (1914) SC 922.

⁸³ 2010 SC (UKSC) 106, the facts of which are discussed at p 4 above. Lord President Carloway in *Lamont v Chattisham* [2018] CSIH 33 at para 19 states that *Inveresk* was a specific exception to the rule that an illiquid claim should not delay payment of a liquid claim, because it was concerned with the payment of a sum of money against a claim of damages. Yet *Inveresk* was decided on the basis of a right to retain due to the mutuality principle. That principle applies to all contractual obligations, not simply payment. Indeed, Lord Drummond Young in *Lamont* at para 35 opines that there is no difference between an obligation to pay money and other contractual obligations, such as delivering goods or performing services.

⁸⁴ See the comments in *McNeill* 2014 SC 335 at para 30.

⁸⁵ Although Lord Malcolm seems to conflate this issue with whether the obligations are reciprocal in *Lamont v Chattisham* [2018] CSIH 33 at para 54; see L Richardson, "What do we know about retention now?" (n2).

⁸⁶ Gloag and Irvine note this as the reason for the decision in *Fisher v Geddes* (1829) 7 S 704: see *Law of Rights in Security* (n77), p314. This is the rule under the DCFR: Art III-3:401(1).

of the breach, until after X,⁸⁷ B is not able to withhold her obligation to pay £y to A.⁸⁸ The issue is determined at the date on which performance is due, not the date at which proceedings are raised seeking implement of an obligation.

As such, as well as obligations having to be counterparts of each other (control 1), the obligations must also be exigible or prestable⁸⁹ at the same time for retention to be available.

(5) Control 5: The Contract Must be Ongoing

A further suggested control, raised in some recent cases,⁹⁰ is that retention is not available where the contract has come to an end.⁹¹ It is not clear why A should not be able to retain performance which was due prior to rescission, in the face of an earlier breach by B of her obligations. Rescission brings parties' future obligations under a contract to an end. It does not have retrospective effect. Other remedies available at common law for antecedent breaches, such as damages, survive rescission. It may be that this control is related to that discussed at B(3), that retention is only available as security for future performance, although the courts have not made any link explicit.

C. How the Law Should Develop

The above analysis sets out the current state of Scots law on the ability to retain contractual performance. There are a number of problems and uncertainties with the law as it stands. As the Scottish Law Commission has not recommended legislative reform of the right to retain⁹² this part sets out how the law may be developed by the courts in the future.

(1) Focus on the Equitable Control

It is argued here that developing the court's equitable control (control three), and using it in conjunction with the requirement that the obligations must be counterparts (control one) and the claims having to be contemporaneous (control four), while removing the need for materiality (control two) is the best way forward.

⁸⁷ If B is not aware of the breach prior to X he will have no foundation for a claim of retention when A seeks payment on X.

⁸⁸ Such were the circumstances in *Redpath Dorman Long Ltd v Cummins Engine Co Ltd* 1981 SC 370, which was held as being correctly decided by the House of Lords in *Bank of East Asia* 1997 SLT 1213.

⁸⁹ See Lord Jauncey's comments in *Bank of East Asia* at 1217-1218.

⁹⁰ *Forster v Ferguson & Forster, Macfie & Alexander* 2010 SLT 867; Lord President Carloway's comments in *Lamont v Chattisham Ltd* [2018] CSIH 33.

⁹¹ Although it seems that mutuality may continue to operate this is not retention: *Forster v Ferguson & Forster, Macfie & Alexander*, *ibid*. See the discussion on p13.

⁹² Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties (n3), para 11.32.

If the equitable control is developed and the ways in which it will operate are more fully understood then there is no difficulty in continuing to adhere to a permissive control one; that all obligations in a transaction are assumed to be counterparts unless the wording of the contract suggests otherwise. In addition, there would be no difficulty in providing that a breach of contract, provided it is not trivial, should permit the right to retain (control two).⁹³ Any attempts at abuse can be regulated via the court's discretion. Removing the need for materiality and providing another form of control accords with the wishes of the legal community.⁹⁴

As discussed above it appears that a major difficulty with the right to retain is that B can suspend performance of all of her contemporaneous counterpart obligations when faced with a sufficiently material breach by A. There is no need for the performance withheld to be in any way proportionate to the effect of A's breach. Focussing on the third control of the right to retain; the equitable control of the court, would deal with this problem head on. It would allow the right to be regulated in a more nuanced fashion than using controls one and two. Controls one and two either allow the right to retain or not: the obligations are counterparts or not; the breach is sufficiently material or it is not. The choice is binary and leaves little room for flexibility. Control three permits flexibility; there may be situations where it is appropriate that B be able to withhold performance of some, but not all of her contractual obligations given the effect of A's failure to comply with his obligations.⁹⁵ The main benefit of control three is its flexibility and the fact that in exercising it the court can take account of the circumstances of the particular case. However, this benefit can also be considered a problem; certainty is important and arguably all the more so given retention can be used as a self-help remedy. Yet, the basis on which the court will exercise its discretion to refuse or otherwise control the right of retention can be established. Thus parties could conduct their affairs applying the particular facts of their case against a framework of factors influencing the court's discretion.

In addition, using the equitable control would prevent some problems with retention in certain cases. Retention in the context of employment contracts has caused difficulties.⁹⁶ Commentators have doubted whether it is correct to hold that the implied term of mutual trust and confidence is not a substantive obligation in an employment contract as determined in *McNeill*.⁹⁷ It appears that the court came to this conclusion in order to limit the right to retain because of the consequences if an

⁹³ This possibility was considered by the Scottish Law Commission in its Discussion Paper on Remedies, 2017 (n1), para 2.34. However, the Commission made no reform proposals on this basis in its Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties (n3) para 11.32.

⁹⁴ Consultees to the Scottish Law Commission's Discussion Paper on Remedies had a mixed response on whether the breach should have to be material, but the majority of consultees agreed that the courts should have the power to deal with abusive or oppressive use of retention: see Report on Formation, Interpretation, Remedies for Breach of Contract and Penalties, 2018, *ibid*, para 11.27.

⁹⁵ A right of partial retention is not unknown to Scots law: see the discussion at p 20 below.

⁹⁶ See *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628; and *McNeill* 2014 SC 335.

⁹⁷ See the discussion in part B(1).

employer or employee was able to retain performance of that obligation. It is suggested that a better way to deal with those difficulties is to find that the implied term of mutual trust and confidence is a substantive obligation such that retention of performance is possible but to find that retention cannot not be used where it would be inequitable in the circumstances of the case. This accords with the approach of the Scottish courts to employment and other personal contracts when specific implement is sought.⁹⁸

Having set out the reasons for advocating development of the equitable control it is necessary to consider how this control should operate.

(2) When and How Should the Equitable Control Operate?

As mentioned in part B(3) there has been only limited discussion of when and how the equitable control should operate. It has been suggested that where retention is used simply as a means to delay having to perform an obligation the court should exercise its equitable control to refuse to allow retention.⁹⁹ This would require an analysis of B's claim of breach by A to determine whether there is a *prima facie* case for retention. Where there is no such case the court would be able to find that B is not entitled to retain her performance, it being inequitable to do so. B would also know that this would happen and would have to bear it in mind before seeking to invoke the right to retain.

It has also been suggested that the court could use its discretion to order B to consign the sum sued for by A to court.¹⁰⁰ As noted above, where this occurs, B is no longer retaining performance but is not giving the benefit of her performance to A. This provides an element of security for both parties – that the sum is available to either of them depending on the outcome of the court action. However, this also has adverse consequences for both parties; during the time the sum is consigned neither can use it.

Given the lack of discussion on the equitable control it may be instructive to consider control of a right similar to mutuality retention, that of special lien.¹⁰¹

⁹⁸ While implement is a remedy available to the pursuer the court can exercise its equitable discretion to refuse the remedy, and does so, in employment contracts: see Macgregor, L. "Specific performance in Scots law" in J. Smits, D. Haas, and G. Heslen, *Specific Performance in Contract Law: National and Other Perspectives*, (2008) p 67.

⁹⁹ Gloag, *Contract*, (n55), p627.

¹⁰⁰ *Inveresk* 2010 SC (UKSC) 106 per Lord Hope at para 34; *Earl of Galloway v M'Connell* 1911 SC 846.

¹⁰¹ See the discussion at p 10 above.

(a) *Special Lien*

Gloag notes that lien, like retention, is subject to the equitable control of the court.¹⁰² The case law shows that where the amount due by the owner of the moveables (A) to the party having possession of them (B) is disputed, as to amount; or because it is alleged that the work done by B is inadequate; or a breach of contract by B has caused A loss, then provided the sum claimed by B is consigned by A, B must give up the corporeal moveables over which she is exercising a lien.¹⁰³ Where there is no dispute as to the amount due by A to B, B need not give up possession of A's property on A consigning the sum claimed,¹⁰⁴ it being noted that consignment of money is not a compulsitor to performance.¹⁰⁵ The equitable control of lien by the courts is to prevent it from being used in an abusive fashion. This is what the equitable control of retention is also seeking to achieve. The next section considers the adequacy of the controls of special lien in the context of retention of contractual performance more generally.

(b) *Adequate Control of Retention*

It is suggested that provided B has a *prima facie* case of breach against A the courts should start from the position that B is entitled to retain performance of her counterpart contemporaneous obligations: the right to retain is available unless and until the court considers its exercise inequitable or its use oppressive. Concern has been expressed that the right to retain must be controlled so as not to undermine the need for contractual performance.¹⁰⁶ Yet, it must be remembered that where there is a readily available right to retain it may improve contractual performance: acting as a compulsitor to performance; where A knows that if he breaches the contract B will be able to retain her performance A is more likely to perform his obligations.

As noted above the equitable control of lien will operate by the court ordering consignment of the sum claimed by the party exercising the right of lien (B) where there is a dispute regarding the sum claimed or the work carried out. The owner of the property (A) must consign all of the sum claimed by B in order that the property be released. However, given there is a dispute about the sum claimed by B, it is not obvious that requiring A to consign the entire sum claimed by B produces justice as between the parties.

¹⁰² Gloag, *Contract*, (n55), p 639. Specific implement is also subject to the equitable control of the court. In *Grahame v Magistrates of Kirkcaldy* (1882) 9 R (HL) 91 Lord Watson stated at 91, "It appears to me that a Superior Court, having equitable jurisdiction, must also have a discretion, in certain exceptional cases, to withhold from parties applying for it that remedy which, in ordinary circumstances, they would be entitled as a matter of course. In order to justify the exercise of such a discretionary power there must be some very cogent reasons for depriving litigants of the ordinary means of enforcing their legal rights."

¹⁰³ *Parker v Brown & Co* 1878 5 R 536; *Garscadden v Ardrossan Dry Dock Co Ltd* 1910 SC 178.

¹⁰⁴ *Ferguson & Stuart v Grant* 1856 18 D 536.

¹⁰⁵ *Ibid* per Lord Curriehill at 538.

¹⁰⁶ See for instance the comments in *Hoult v Turpie* 2004 SLT 308 at para 14.

In addition, special lien is a more limited right than a right to retain contractual performance based on the mutuality principle. Special lien is exercised over corporeal moveables owned by A in B's possession. Retention can relate to any obligation owed under a contract; an obligation to do or not do something, or to pay a sum of money. Furthermore, there is arguably a more obviously direct link between the obligations in relation to special lien. A provides B with his property in order that B does something with or to that property. Where A does not do what is required of him (paying the price for the work), B is able to retain A's property until he does so.¹⁰⁷ With retention there is an assumption that all of the obligations in a transaction are the counterparts of the other. There may therefore be less of an obviously direct link between the obligation breached by A and the performance which B is retaining. Hence it is suggested there is a need for a more rigorous equitable control of retention; essentially the need for a stronger control three given control one is permissive.

It is suggested that the court should exercise the control of retention in a more nuanced manner. The court should consider the breach alleged to have been committed by A in terms of its value and impact on B; and the value of the obligations that B is withholding and the impact this has on A in determining whether, and to what extent, B should be able to retain her performance. Without taking account of these factors the flexibility of the equitable control is not utilised fully with the potential for inequitable results. This may be illustrated by some examples.

Example 1: A sues B for £100,000. B claims that A is in breach of the contract in terms of which A is suing B. B claims losses as a result of the breach of £5,000. In those circumstances should B be able to retain performance of her entire obligation to pay the sum of £100,000? It is suggested that this should initially depend on whether B has a *prima facie* case in respect of both the breach and the loss claimed to flow from it; in other words the court is satisfied that a plea of retention has a foundation. A further factor is that B's claim is, at best, £5,000. In such circumstances it seems unreasonable that she is able to retain all of the sum due to A. Yet it is also unreasonable to allow A all of the benefits of B's performance when A is in breach of contract himself. It may therefore be more appropriate that B is able to retain part of her performance and partially perform her obligations to A.

Example 2: A sues B for a sum of £5,000 and B claims that A is in breach of contract, resulting in loss to her of £10,000. Whether B should be able to retain would again depend on whether B has a *prima facie* case of breach by A and resulting loss. If the court is satisfied that B's claim has a foundation it seems reasonable that B is able to retain all of her contractual performance given her damages claim exceeds A's claim against her.

¹⁰⁷ Although the property retained can far exceed the value of the claim, for instance the retention of a ship in respect of a bill for repairs to the ship in *Garscadden v Ardrossan Dry Dock Co Ltd* 1910 SC 178.

The discussion above, especially example 1, highlights a major difficulty with retention; that, as it currently operates, B is able to withhold all of her obligations in the face of A's breach. It is suggested that partial retention of performance should be available, as well as retention of all counterpart obligations.¹⁰⁸ Whether whole or partial retention should be possible will depend on the value and impact of the obligation sought to be retained by B and that alleged to have been breached by A. While this is a departure from our current understanding of the law of retention it is not entirely unknown to Scots law.

(c) Partial retention

Where a tenant does not obtain possession of all of the subjects let he is able to abate the rent corresponding to the extent of possession not received.¹⁰⁹ Here there is a clear link between the extent of the landlord's breach and the tenant's right to retain part of the rent.¹¹⁰ In discussing a tenant's right to withhold rent, where he does have possession of the subjects but the landlord has failed in an obligation incumbent upon him in term of the lease, Hume states,

to be quite fair and equitable, this sort of retention [retention based on mutuality of contract], must however be allowed under certain limitations only, which spring out of the situation of the contracting parties.....¹¹¹

He goes on to note that where the landlord is in breach of the lease the courts have generally been disposed to restrict the right of retention to the probable amount of the tenant's claim in damages.¹¹² In such a situation the tenant is able to use the leased premises but his ability to do so is impeded by the landlord's failure to adhere to his obligations. The tenant is able to partially withhold rent reflecting the loss caused to him by the landlord's breach. Rankine notes that while Hume's views have not been expressly recognised by the courts they are "worthy of citation" on account of their "apparent reasonableness".¹¹³

Hume's views were, in time, recognised by the court in cases in the mid-twentieth century. In *Stobbs & Sons v Hislop*¹¹⁴ Lord President Cooper noted *obiter* that in disputes between landlord and tenant the courts have made "innumerable

¹⁰⁸ McBryde suggests that when the right to retain exists it is a complete right: see McBryde, *Contract* (n4), para 2.68. However, he does not consider the equitable control of the right to retain, which as noted at p 10 above, was a feature in older cases and has only recently resurfaced. In *Macari v Celtic Football and Athletic Co Ltd* 1999 SC 628 the court stressed that the party with the right to retain must exercise it in full and cannot choose which of his obligations he will perform and which he will not. It is argued that the reason for such comments was due to the effect a finding of partial retention would have in the particular context of a contract of employment; such a finding would allow the employee to disregard the employer's instructions regarding health and safety (at 643).

¹⁰⁹ *Graham v Gordon* (1843) 5 D 1207; and *Munro v M'Geogh* (1888) 16 R 93.

¹¹⁰ Abatement can relate, but does not necessarily have to relate to, the landlord's breach of the lease: see Rennie et al, *Leases* (2015), para 17.55.

¹¹¹ *Bowie v Duncan*, 1807, Hume, 839 at 839.

¹¹² *Ibid.*

¹¹³ J Rankine, *A Treatise on the Law of Leases in Scotland*, 3rd ed (1916), p 328.

¹¹⁴ 1948 SC 216.

refinements” to the right to retain including partial withholding of rent¹¹⁵ and that account has been taken of the materiality of the landlord’s breach and the probable damage sustained by the tenant before deciding whether, and if so, how much rent the tenant could retain.¹¹⁶ Furthermore, in an Inner House decision of seven judges¹¹⁷ the court noted that in pleading retention a defender tenant was inviting the court to exercise in his favour the discretionary equitable power, which the Court had long asserted in dealing with reciprocal obligations arising under mutual contracts, of permitting one party to withhold in whole or in part his obligations until the landlord had performed.¹¹⁸

Outside of the realm of leases, the court has allowed an abatement of the price where machinery was installed that was disconform to contract.¹¹⁹ In relation to lump sum building contracts¹²⁰ the court has found the builder entitled to payment where his breach was not material. However the price was reduced by the amount needed to make the property conform to contract.¹²¹ In these cases the employer was entitled to retain part of his performance given the contractor’s breach.

It may also be noted that Art III-3:401(4) of the DCFR allows for whole or partial withholding of performance as may be reasonable in the circumstances. Parties may disagree about what is reasonable. For the reasons set out in the next section it is suggested that the court’s equitable control should operate in a more structured fashion than simply what is reasonable in the circumstances.

(d) Shaping the Court’s Equitable Control

It must be remembered that this control is based on the court exercising an equitable discretion. However, discretion does not inevitably mean uncertainty. Judicial discretion can, and is often, restricted by factors that the court should take into account.¹²² This has happened in the equitable discretion of the court to refuse

¹¹⁵ *Ibid* at 223.

¹¹⁶ *Ibid* at 226. Here Lord President Cooper specifically refers to the case in which Hume set out his views; in the report of *Bowie v Duncan* (n111).

¹¹⁷ *Brodie v Ker* 1952 SC 216.

¹¹⁸ *Ibid* at 226.

¹¹⁹ *Dick & Stevenson v Woodside Steel & Iron Co* (1888) 16 R 424.

¹²⁰ In such contracts a sum is to be paid for the whole building being built; this is in contrast to a measure and value contract in terms of which particular sums are provided in the contract for each element of work to the building.

¹²¹ *Ramsay v Brand* (1898) 25 R 1212; *Speirs v Petersen* 1924 SC 428. The former case was doubted in *Forrest v Scottish County Investment Co* 1915 SC 115, but was approved in *Speirs*. While this line of authority has been criticised (see the Scottish Law Commission 1999 Report on Remedies (n12), paras 7.25-7.27) the defender’s counterclaim need not be damages based on a reinstatement value, which would often eclipse the sum sued for by the pursuer. Considering damages on a diminution of value basis would have allowed the court to come to an equitable solution between the parties in *Steel v Young* 1907 SC 360 instead of holding that the pursuer was not entitled to sue on the contract, leaving to him an action in enrichment against the defender.

¹²² N Whitty, argues that even when faced with a wide discretion judges will apply informal rules of thumb to achieve sufficient certainty and predictability; “From Rules to Discretion: Changes in the Fabric of Scots Private Law”, 2003 ELR 281, p 299-300.

specific implement, to the extent that there are categories of cases identified where specific implement will not be permitted.¹²³ This section, drawing on the discussion above, sets out the factors that should be used to help shape the use of the equitable control of retention.

The court should initially consider whether there is a *prima facie* basis for retention in order to be satisfied that it was not being pled simply to delay performance by the defender. Thereafter the court should consider the value of the breach of contract B claims has been committed by A, together with its effect on B, and consider this against the value of the performance B seeks to retain and its impact on A. While this article has highlighted that a major difficulty with the current law of retention is that there is no need for the performance retained to be proportionate to the breach, it is not suggested that the court should consider whether the performance retained by B is proportionate to A's breach. This may be possible for the court but may be finely balanced and difficult to determine. Retention is available not simply as a defence, but also as a self-help remedy. Indeed, retention may be utilised most often as a self-help remedy. As such the equitable control of the remedy must be easily understood by parties and should not be difficult to apply. In addition, retention can act as a compulsitor to performance, and that would be diminished too greatly where the performance retained by B had to be proportionate to the obligation breached by A.

It is therefore suggested that the test should be whether the performance retained by B is clearly disproportionate to A's breach.¹²⁴ Given retention is available as a right unless the court considers its use inequitable it is suggested that the onus of proof would be on A to take issue with B's use of retention and to prove that the performance being retained by B was clearly disproportionate to his own breach of contract.¹²⁵ Finally, the court could have regard to any policy considerations, for instance the effect of permitting retention in the context of certain types of contracts, such as employment contracts.¹²⁶ This aspect would develop over time as different types of contracts are considered by the courts.

¹²³ McBryde, *Contract* (n4), para 23.15; L Macgregor, "Specific Performance" (n98), L Macgregor and H MacQueen, "Specific Implement, Interdict and Contractual Performance", 1993. ELR 239.

¹²⁴ This is similar to the position adopted in Austrian law where the right to retain is limited by ABGB §1925(2) which prevents the abuse of a right to withhold; such abuse can be found in a flagrant disproportion in the interests of the parties: see the commentary to Art III-3:401 of the DCFR in the full edition (n37), p848. The test proposed is not dissimilar to the test applied in determining whether a clause is a penalty. In *Cavendish Square Holding BV v Makdessi* [2016] AC 1172 the Supreme Court held that for a clause to be held to be a penalty, and as such unenforceable, it would have to be shown that the detriment to the party in breach was out of all proportion to any legitimate interest in the innocent party in enforcing the primary obligation.

¹²⁵ This would accord with the position when specific implement is sought; it is for the defender to demonstrate to the court that it should not be granted.

¹²⁶ See the discussion at p 5-6, 12 and 16-17 above regarding the difficulties retention has caused in such contracts. The court will refuse to grant specific implement in contracts involving a personal relationship.

In developing the right to retain in this way the remedy will be more widely available; there being no need for the breach to be material. Yet the remedy can be kept within certain limits to ensure that it is not abused. The suggested changes also provide greater certainty than the current position given that it is unclear what level of materiality is needed before there is a right to retain and, even when that extent of materiality is determined, there may also be difficulties in identifying when the appropriate level has been reached on the particular facts of a case. At the same time, the suggestions advocated here provide some flexibility to the remedy; it no longer being a question of whether retention is available or not but whether, if retention is available, it should be complete retention or partial and the extent of any partial retention, taking into account the value and effect of the breach against the value and effect of the performance retained. By doing so this deals directly with one of the major concerns with the right to retain; that B can retain all of her performance which may be out of all proportion to A's breach.

D. Conclusions

This article has demonstrated that there are currently difficulties with the right to retain contractual performance in Scots law. There are a number of controls, some of which have been more fully developed than others in the case law. Yet the cases have generally focussed on one of the controls and have not considered all of the controls and how they interact with each other. Such analysis is needed in order to determine how best to control retention. In addition, focussing on the extent and limits of a particular control has often clouded the problem with retention that the controls should be seeking to regulate; that the remedy, when available, can be extreme and result in inequitable results between the parties. In trying to avoid such a result in a particular case the courts have, it is suggested, sought to control retention in ways that are doctrinally unsound, such as limiting retention to substantive obligations only; or restricting its use to circumstances where it is available as security for future performance only. In seeking to come to the correct decision in any given case the law of retention has become distorted by the courts.

Having considered the controls together, and focussing on the reasons why the right to retain needs to be controlled, it is argued that this is best done by developing the equitable control of the right, and in particular, recognising a right of partial retention. That this is the exercise of a discretion by the court does not mean that the control operates in an uncertain manner. Section C(2)(d) above sets out a framework for the exercise of that discretion, ultimately asking whether the performance retained by B is clearly disproportionate to A's breach of contract. This framework can be utilised by judges tasked with making a decision but also, and importantly, can be understood and used by contracting parties and their advisers in determining whether and to what extent a right to retain is available.

The suggestions made in this article would allow the right to retain to be clarified and controlled in a more conceptually coherent fashion. Furthermore, controlling retention as suggested brings Scots law into closer alignment with other civilian systems where the right to retain is recognised, rather than seeking to use the English law concept of requiring a serious or material breach, which, as noted above is a standard more suited to rescission, not retention. It is hoped that a suitable case comes before the courts in the near future in order to clarify some of the current issues with this remedy, which are causing problems for contracting parties and their advisers. More importantly, it is imperative that this important remedy is considered in a structured manner. Only then will there be a coherent understanding of the law of retention of contractual performance.